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In the Supreme Court of the United States

OCTOBER TERM, 1977

M & M LEASING CORPORATION, ET AL., PETITIONERS

v.

SEATTLE-FIRST NATIONAL BANK, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE COMPTROLLER OF THE CURRENCY IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A-1 to A-19) is reported at 563 F. 2d 1377. The first opinion of the district court (Pet. App. B-1 to B-12) is reported at 391 F. Supp. 1290. The district court's supplemental opinion (App., *infra*), is reported at 391 F. Supp. 1296.

JURISDICTION

The judgment of the court of appeals was entered on November 4, 1977. A timely petition for rehearing was denied on December 23, 1977. The petition for a writ of certiorari was filed on March 20, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether automobile lease financing is part of the "business of banking" authorized by the National Bank Act, 12 U.S.C. 24 (Seventh), when the lessor bank assumes no material burdens other than those of a lender of money and is subject to no significant risks not ordinarily incident to a secured loan.

STATUTE INVOLVED

The National Bank Act, as amended, 12 U.S.C. 24, grants national banks the power, *inter alia:*

> Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be neccessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter. * * *

STATEMENT

At least 1,000 national banks now lease personal property, and forty states authorize banks to do so (Pet. App. A-8, B-4). Although much of this leasing involves relatively expensive items such as aircraft or ships, many banks now lease motor vehicles (Pet. App. B-4). The role of the bank in automobile leasing is principally that of financier. The customer and an automobile dealer usually agree on the make, model and accessories of the vehicle, term of the lease, and payment schedule, in a manner consistent with the dealer's agreement with the bank (Pet. App. A-5). The bank then reviews the proposed lease to determine the credit-worthiness of the lessee. If the lease is

approved, the lessee makes payments to the bank, which is the legal owner of the car (*ibid.*). The lessee bears operating risks and costs of maintenance, repairs, and insurance (Pet. App. A-6). Automobile leases ordinarily have a term of two to three years (Pet. App. B-5).

Petitioners, four corporations engaged principally in leasing motor vehicles, brought this action in the United States District Court for the Western District of Washington against the Comptroller of the Currency, two national banks, and the banks' leasing subsidiaries (Pet. App. B-1 to B-2). Alleging that motor vehicle leasing is not a permissible activity for national banks, petitioners sought declaratory and injunctive relief prohibiting such activities by the two banks and setting aside the Comptroller's interpretive rulings, 12 C.F.R. 7.3400 and 7.7376 (see Pet. App. C-6 to C-7), which authorize leasing under certain restrictions (Pet. App. A-2, B-2).

The district court held that open-end leasing[1] is a permissible banking activity but that most closed-end leasing[2] is not. The district court explained (Pet. App. B-8 to B-9):

> [T]he open-end motor vehicle lease * * * is merely a variation in the traditional manner of extending credit and is the functional equivalent of a loan on

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[1]In an open-end lease the lessee guarantees payment to the bank, at the termination of the lease, of a lump sum equal to the projected residual value of the automobile (Pet. App. B-5 to B-6). If the leased automobile is sold for an amount less than the guaranteed residual value, the lessee makes up the deficiency to the bank. If the sale produces an amount in excess of the guaranteed residual value, the bank receives the guaranteed amount and the lessee receives the excess (*ibid.*). Almost all of the vehicle leases by the two respondent banks are open-end leases (Pet. App. B-6).

[2]The closed-end lease contains no guarantee of the residual value of the leased vehicle at the termination of the lease (Pet. App. B-6). The bank thus assumes the risk that the sale of the used vehicle will not yield the amount projected at the time the lease was executed.

> personal security. Specifically, the open-end lease differs only insignificantly from a conditional sales contract with a final balloon payment. The lease customer assumes all of the burdens and risks of ownership of the automobile. The bank, during the lease term, is repaid the cost of the vehicle together with the cost of financing the transaction out of a combination of rentals and guaranteed residual payment, and sometimes tax benefits also. The bank is promised a pre-established financial return, with only the usual risks inherent in any credit transaction.

The district court concluded that closed-end leasing is not permissible unless the term of the lease "exhausts the usable life of the leased property so that the bank does not rely on any residual value in its calculation of its expected financial return" (Pet. App. B-9).[3]

A divided panel of the court of appeals affirmed in part and reversed in part, concluding that "the trial court's holding [is] correct, so far as it goes, but [is] somewhat more restrictive than the law requires" (Pet. App. A-4). The court of appeals stated (*ibid.*):

> [T]he "business of banking," which 12 U.S.C. §24, Seventh, authorizes the [respondent banks] to conduct, includes leases of personal property when, in the light of all relevant circumstances, the transactions constitute the loan of money secured by the properties leased. A transaction may be so

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[3]Upon reconsideration the district court rephrased its holding as a conclusion that leasing of motor vehicles and other personal property is a permissible banking activity provided "the lessor bank, during the initial lease term, is repaid the cost of the property leased plus the cost of financing the transaction, in the form of rentals, tax benefits and/or the guarantee * * *." App., *infra*, p. 2a.

> characterized, in our opinion, even if it is designed so that the lessor bank does not recover during the initial lease term every penny of the cost of the leased property plus its financing costs. A lease ceases to be a secured loan when the lessor assumes material burdens other than those of a lender of money and is subject to significant risks not ordinarily incident to a secured loan.

Under the court of appeals' approach short-term car rentals and leases in which a bank provides procurement or operational services, such as maintenance or insurance, are impermissible activities for national banks (Pet. App. A-11), but both open-end and closed-end leasing are permissible.[4]

ARGUMENT

The "incidental powers" clause of the National Bank Act, 12 U.S.C. 24 (Seventh), authorizes national banks to exercise "all such incidental powers as shall be necessary to carry on the business of banking * * *." Although the decision here is apparently the first to pass on the precise question whether national banks may lease automobiles, it does not announce any new standard of construction for the incidental powers clause of the National Bank Act. The court of appeals was correct in holding (Pet. App. A-9) that any activity functionally equivalent to an express

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[4]The court of appeals also stated that the Comptroller's interpretive rulings, 12 C.F.R. 7.3400 and 7.7376, did not adequately confine leasing activities by banks to the statutory standard (Pet. App. A-13). On November 29, 1977, the Comptroller published for public comment a proposed revision of 12 C.F.R. 7.3400 that would conform the Comptroller's stated views to those of the court. 42 Fed. Reg. 60749; see also 42 Fed. Reg. 61058. A new interpretive ruling has not yet been issued in final form.

banking power—here, the power of "loaning money on personal security," 12 U.S.C. 24 (Seventh)— is within the incidental powers of national banks. Cf. *Franklin National Bank* v. *New York*, 347 U.S. 373, 377; *Merchants' Bank* v. *State Bank*, 10 Wall. 604, 648. The court of appeals adhered to the standard adopted in *Arnold Tours, Inc.* v. *Camp*, 472 F. 2d 427, 432 (C.A. 1), that "a national bank's activity is authorized as an incidental power 'necessary to carry on the business of banking,' within the meaning of 12 U.S.C. §24, Seventh, if it is convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act." See Pet. App. A-8 to A-9. Petitioners do not contend either that there is a conflict or that the essential principle of *Arnold Tours* is incorrect (Pet. 18).[5] Any more restrictive view of the powers of national banks would prevent national banks from adopting new methods to meet new demands (Pet. App. A-9).

Petitioners argue, however, that automobile leasing is inherently a merchandising activity, not a banking one (Pet. 21-22). The court of appeals correctly rejected that contention (Pet. App. A-4 to A-8). Leasing is a method of providing money (the cost of the car) against the prospect of payments (rent), secured by the value of the car.

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[5]The decision here is in accord with *National Automobile Dealers Association, Inc.* v. *Board of Governors*, C.A.D.C., No. 76-2021, decided February 21, 1978, petition for a writ of certiorari pending, No. 77-1483, which upheld a regulation of the Federal Reserve Board, 12 C.F.R. 225.4(a)(6), as amended, 41 Fed. Reg. 45977, 45984. The Federal Reserve regulation determines that automobile leasing by bank holding companies, when conducted in accord with the restrictions set forth in the Board's regulation, "is essentially a financial transaction that is functionally equivalent to a bank's lending function." 41 Fed. Reg. 45978.

Leasing retains this financial character as long as the lessor assumes no "material burdens other than those of a lender of money and is subject to [no] significant risks not ordinarily incident to a secured loan" (Pet. App. A-4). The decision of the court of appeals makes it plain that banks may not provide merchandising services associated with the short-term car rental business such as procurement, maintenance, insurance, or licensing (Pet. App. A-11).

The court of appeals held that the disposal of the property at the termination of the lease does not alter the essentially financial character of the lease transaction. The court found that "functions incident to the disposal of the property at the expiration of the lease[,] * * * [s]o long as [they] * * * constitute only the orderly liquidation of the bank's security[,] * * * remain within the business of banking" (Pet. App. A-11). Petitioners argue that this conclusion is the "basic misapprehension" of the court's opinion because, according to petitioners, "[f]ull realization on the residual value projection is essential to business success in the automobile leasing field" (Pet. 22, 23). But petitioners' contention (even if one overlooks the absence of any citation to evidence that might support it) amounts to no more than a disagreement with the conclusions that the court drew from the information before it.[6] Petitioners do not argue that the Comptroller's interpretive ruling is not supported by substantial evidence, and there is no need for this Court to review the factual dispute concerning the importance in the automobile leasing business of recovering the projected residual value of leased vehicles.

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[6]The court of appeals recognized that the vehicle's residual value was one of the "crucial items" in the leasing decision (Pet. App. A-5).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1978.

DOJ-1978-05

APPENDIX

M & M LEASING CORPORATION ET AL.,
PLAINTIFFS,
v.
SEATTLE-FIRST NATIONAL BANK ET AL.,
DEFENDANTS.

M & M LEASING CORPORATION ET AL.,
PLAINTIFFS,
v.
PEOPLES NATIONAL BANK ET AL.,
DEFENDANTS.

Civ. Nos. 508-73C2, 509-73C2.

United States District Court,
W. D. Washington.

As Amended April 10, 1975.

ORDER ON RECONSIDERATION

Defendants seek clarification of the opinion issued March 13, 1975, wherein this Court found a certain type of closed-end lease to be outside the powers granted to national banks by the National Bank Act. Defendants' concern is that the opinion does not adequately distinguish between closed-end leases providing for full pay-out on the one hand, and closed-end leases which do not provide for full pay-out on the other hand. Since the banks participate in many closed-end leases of "big ticket" items, their concern is understandable. I am issuing this Order to obviate misinterpretation of the decision. As noted in the opinion, the National Bank Act does not empower banks to engage in any lease transaction in

which the bank assumes the risk of residual value fluctuation. Lease transaction in which the lessor bank, during the initial lease term, is repaid the cost of the property leased plus the cost of financing the transaction, in the form of rentals, tax benefits and/or the guarantee of a financially responsible guarantor, are within the powers enumerated in the National Bank Act and neither disapproved in the Court's opinion nor enjoined by the judgment entered herein. Leases in which the lessor must look to the residual value of the leased property to realize its financial return are not within the powers authorized in the Act.

The judgment provides that the defendants are enjoined from engaging in "motor vehicle lease transactions in which the banks assume the risk of residual value fluctuation upon termination of the lease." Plaintiffs and the defendant banks move to amend this judgment by deleting its reference to "motor vehicles." Defendant Comptroller, however, objects to this amendment on the basis that, since the plaintiffs are engaged almost exclusively in motor vehicle leasing, only such leasing can be affected by the Court's decision. The Court sees no basis for distinguishing between the general activity of leasing and the activity of leasing a particular commodity. Neither the Comptroller's regulations, nor the Federal Reserve Board's rules as applied to bank holding companies and their non-bank subsidiaries, make such a distinction. Nor, in fact, did the defendants, including the Comptroller, make such distinction in the trial of this case. On the contrary, the evidence presented by the defendants and, in particular, by the Comptroller, covered the entire range of defendant banks' personal property lease financing. Accordingly, the opinion and the judgment herein are applicable thereto.

The Clerk of this Court is hereby ordered to enter an amendment to the judgment deleting the words "motor vehicle."